NEWMONT AUSTRALIA

Newmont Australia Limited
ABN 86 009 295 765
100 Hutt Street, Adelaide 5000
South Australia, Australia
Telephone: +61 8 8303 1700
Facsimile: +61 8 8303 1900
Direct Facsimile: +61 8 8303 1955
www.newmont.com

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Mr Robert Pullella
Executive Director – Competition, Markets and Electricity
Economic Regulation Authority
PO Box 8469
Perth Business Centre
PERTH WA 6849

Via email: public_consultation@era.wa.gov.au

Dear Mr Pullella

WESTERN POWER'S REVISED PROPOSED ACCESS ARRANGEMENT
TREATMENT OF CAPITAL CONTRIBUTIONS

Newmont welcomes the opportunity to provide further comment to the Authority on aspects of the treatment of capital contributions in Western Power's Revised Proposed Access Arrangement.

Newmont is of the view that the whole issue of capital contributions remains controversial and unfortunately has not been adequately addressed in the Access Code or, as a result, in the Revised Proposed Access Arrangements. We base this view on Newmont's experiences in dealing with capital contributions under the previous regime, and more recently in the transition period to the proposed new access arrangements. We pass the observation in referring to our experience that Newmont, its associates and its predecessors have, over the past 25 years, been one of the largest providers of capital contributions (in various forms) to Western Power and its respective predecessors.

In formulating the Access Code the lawmakers apparently wished to maintain the paradigm whereby users whose needs dictated capital expenditure on the network would fund this capital expenditure, but that the assets so funded would be owned by the Network Operator. Whilst we have some difficulty in drawing the line between "normal" load growth in the network which requires capital expenditure, and individual users needs, we accept that this is the intent of the code.

The difficulty in finding a satisfactory solution to the capital contribution arrangements under the Access Code is bore out by progress of the current Access Arrangement assessment process: Western Power's proposal in the original Proposed Access Arrangement to establish an arbitrary "urban shared network" zone as a method to "sort out" some of the capital contributions problem was rejected by the Authority, and the most recent (17 January 2007) Call for Submissions (as the assessment process is being finalised), in which two of the issues relate to capital contributions, evidences a lack of firm direction on the issue. We also believe Western Power's proposals add complexity to what is a very simple issue.

Newmont's view is that the overarching (and relatively simple) principle which must be applied is that if a network user makes a capital contribution then the Network Operator should **not** be permitted to earn a return of or on that capital for the life of the assets funded. From this principle arise two outcomes:

- The user should not pay for the capital cost of such assets in any ongoing access charges for the life of the assets (otherwise that user will be funding the assets twice)
- The Network Operator should not receive any revenues from other users related to the capital cost of the assets. Other users who make use of the assets funded by a capital contribution (over the life of these assets) should pay full access charges (including an amount attributable to return of and on the capital cost of those assets, calculated in a manner consistent with the access arrangement methodology) to the Network Operator, and the Network Operator should pass in full the amount attributable to return of and on the capital cost of those assets to the original provider of the capital contribution[1].

Newmont believes that this principle is consistent with the intent of the Access Code, which requires that (from section 5.12 of the Access Code) "the objectives for a capital contributions policy must be that:

(a) in respect of a *required augmentation*, it strikes a balance between the interests of:
(i) the *contributing user*; and
(ii) other *users*; and
(iii) *consumers*;

and

(b) it does not constitute an inappropriate barrier to entry."

We note that the objectives of the capital contributions policy do **not** require the interests of the Network Operator to be considered, and instead prescribes the issues to be considered by the Network Operator in preparing a capital contributions policy for inclusion in its access arrangement. The onus is thus placed on the Authority in ensuring that the interests of the contributing user, users and consumers are balanced whilst having regard to the objectives of the Access Code (viz) to promote the economically efficient investment in and operation of

[1] Alternatively, the Network Operator could "buy out" the contributing user's interest in the line by providing an appropriate refund of some or all of the capital contribution plus an appropriate return to date on the capital invested by the contributing user. In these circumstances the Network Operator would regain the right to earn a return of and on the respective portion of the assets.

and use of networks and services of networks in Western Australia in order to promote competition in markets upstream and downstream of the networks.

Unfortunately the Access Code and the Model Capital Contributions Policy deal mainly with the issue of how to calculate the capital contribution, rather than the issues associated with dealing with the funds once received by the Network Operator and balancing the interests of others, and it is these latter areas which have not yet been dealt with adequately in the Revised Proposed Access Arrangement.

Newmont is additionally of the belief that the Model Capital Contributions Policy contained in the Access Code is flawed in prescribing, in A4.10, a relatively short time frame of 15 years when dealing with network assets with useful lives of 50 years or more, and/or relating the capital contributions calculation to the life of the applicant's activities, which is irrelevant with respect to funding (by that applicant) the network assets to be built. The effect of these is to allow the Network Operator to earn an income on assets fully funded by others after the "reasonable time" period has passed. Newmont is considering moving to seek to have the Access Code amended to reflect a more appropriate time period and the deletion of reference to the applicant's purpose in the Model Capital Contributions Policy, and in the meantime asks the Authority to exercise its discretion with respect to this item in approving the Capital Contributions Policy in Western Power's Revised Proposed Access Arrangement.

We also note that the Capital Contributions Policy in Western Power's Revised Proposed Access Arrangement (in 10.1(a)(ii)) prescribes a maximum period from the time a contribution is made during which rebates will be provided. This period is one of the items which the Authority must approve. Newmont is of the view that the 5 year period contained in the policy is too short, firstly because if there is a major augmentation to be built there may (due to construction lead times) only be an actual operating period as short as (say) two years during which the contributing user may gain benefit from any rebate, and secondly because the 5 year period is manifestly too short with respect to network assets with lives in the order of 50 years. Again the effect of this clause in the Capital Contributions Policy is to allow the Network Operator to derive revenue from assets funded by contributing users.

The further perverse outcome of these arrangements is that the Network Operator has an incentive to minimise the duration of any access agreement and to minimise the period any rebate is provided, so that the assets can be "freed up" any from any obligation to the contributing user. This then allows the Network Operator to earn a return of and on the assets for the balance of the asset life, despite having provided <u>no</u> capital for their construction.

Returning to the application of the principle we stated above, Newmont is thus opposed to the proposition that Western Power should add capital contributions (forecast or actual; adjusted or unadjusted) to its SWIN capital base. The immediate impact of this is that the user who made the capital contribution will be paying more in access charges and will effectively be paying for the same capital twice (given that the increase in charges is not contemplated in calculating the capital contribution). Further the proposition to reduce all users' charges in the year of the capital contribution (to offset the future increases) allows all other users to enjoy the benefits of one user's capital contribution. In particular where there are large capital contributions it is likely they relate to significant capital works which will not be completed until some time (possibly several years) after the contribution is made. In this case the user who made the capital contribution will not even enjoy the one-off lower costs as it will not yet even be paying access charges at the time of the charge reduction. Both aspects of these proposals amount to appropriation of that capital contribution by the government for the benefit of the community, at the expense of the contributing user.

We lastly note that the Authority's Call for Submissions (17 Jan 2007) discusses the potential impact on Western Power's cashflow (an issue which we believe, as an aside, is Western Power's problem, as they have proposed the methodology) and on users in general, but does not give any consideration to the impact on contributing users who make the capital contributions. We believe the Authority's paper is deficient in failing to identify and discuss this issue, as appears to be required by the Access Code (section 5.12) in specifying the objectives of a capital contributions policy.

Should you have any queries on this submission, please contact the undersigned.

Yours sincerely

David Lyne

Manager Energy Services